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IN THE

Supreme Court of the United States

OCTOBER TERM, 1957

No. 983

TELESERVICE COMPANY OF WYOMING VALLEY, *Petitioner*

v.

COMMISSIONER OF INTERNAL REVENUE, *Respondent*

On Petition for Writ of Certiorari to the United States Court of Appeals for the Third Circuit

REPLY TO RESPONDENT'S BRIEF IN OPPOSITION

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INTRODUCTORY STATEMENT

The legal issue between the parties has been fairly joined—whether funds paid as reimbursement for the construction of capital facilities constitute taxable income, because operation of the facilities makes possible the furnishing of services to contributors who pay monthly charges. As heretofore noted (Pet. 3), the facts of the case are not in dispute. However, petitioner believes that respondent's abbreviated statement

(Res. Br. 3-6) fails to state some of the facts of record, set forth in the opinion of the Court below, which are material to the consideration of the question presented. The facts believed essential to a proper resolution of the issue herein, including those which are set forth in respondent's statement, are summarized from the Circuit Court's opinion (Pet. 1a-16a) in petitioner's statement of the case (Pet. 3-7).

The paragraphs of the reply are numbered to correspond to those of the brief for the respondent in opposition. Points heretofore urged in the petition for writ of certiorari not here restated are of course preserved.

REPLY TO RESPONDENT'S ARGUMENT

1. There is no dispute between petitioner and respondent that this Court has repeatedly held that in adopting the broad definition of income of Section 22(a) of the Internal Revenue Code of 1939, the Congress intended to tax all *gains* except those specifically exempt. *Commissioner* v. *Lo Bue*, 351 U.S. 243 (1956); *Commissioner* v. *Glenshaw Glass Co.*, 346 U.S. 426 (1955); *Robertson* v. *United States*, 343 U.S. 711 (1952). The thrust of petitioner's argument in this case, however, is that this Court in so holding has never equated *gains* with *capital*, the effective result of the decision here complained of. Indeed, in the *Glenshaw Glass* case cited by respondent, this Court specifically observed that the definition of income in *Eisner* v. *Macomber*, 252 U.S. 189, 207 (1920) as "the gain derived from capital, from labor, or from both combined" served a useful purpose in the context of *distinguishing gain from capital*, the very distinction urged here by petitioner as determinative.

In the companion case to *Glenshaw Glass* decided the same day, *General American Investors Company* v. *Commissioner*, 348 U.S. 434, 436 (1955), the Court made reference to *Texas & Pacific R. Co.* v. *United States*, 286 U.S. 285 (1932), which in its context of capital contributions illustrates that this Court has not intended to dilute the basic distinction made in that case between contributions in aid of *capital* construction and income payments for *operation* of the facility (see Pet. 7-9).

The Circuit Court decisions cited by respondent (Res. Br. 7) flow from this same distinction. In *Lykes Bros. S. S. Co.* v. *Commissioner*, 126 F. 2d 725 (5th Cir., 1942), the payments in question were made to a shipping company for carrying the United States mails, and were thus income from operation, disassociated from a separate contractual obligation to spend a stated sum within the succeeding ten years on building new ships or reconditioning old ones. As the Board of Tax Appeals there said below, 42 B.T.A. 1395, 1404 (1940):

> "An important fact in this case is that the mail payment income was directly dependent upon operations. If petitioner operated its vessels and carried ocean mails it was to be compensated therefor, based upon mileage and the class of vessel operated. The income was not, as in *Cuba Railroad Co.*, dependent on construction * * *."

In *Baboquivari Cattle Co.* v. *Commissioner*, 135 F. 2d 114 (9th Cir., 1943), the payments in question were made to farmers for compliance with conditions in respect of the *use* of his land, and were thus also income for operation. In *United States* v. *Maryland Jockey Club*, 210 F. 2d 367 (4th Cir., 1954), cert. den. 347 U.S. 1014 (1954) the payments in question were deducted

from gross amounts taken in from pari-mutuel betting at a race track, under State law which required that they be kept in a special fund for improvements, and thus again were income received and collected as a result of operation.

Application of the test is illustrated in the opinion of the late Chief Judge Parker in the precursor of the cases cited, *Helvering* v. *Claiborne-Annapolis Ferry Co. of Annapolis, Md.*, 93 F. 2d 875, 876 (4th Cir., 1938): "Taxpayer's capital was invested in wharves and ferryboats; and the payment by the state was intended, not to reimburse taxpayer for expenditures it had made in their purchase or equipment, but to compensate it in part for their operation."

The distinction between funds for capital construction and income from operation, based upon the nature of the sums in the hands of the taxpayer, and not the motives of or benefits to the contributors, is precisely the touchstone here urged by petitioner as the basic teaching of *Edwards* v. *Cuba Railroad Co.*, 268 U.S. 628 (1925), which is controlling in this case. The fundamental fact of this case is that petitioner here, as in *Cuba Railroad*, first constructed its capital facilities and then received contributions therefor from its donors, so that the funds could not go elsewhere than as reimbursement for capital expenditures. The fundamental error of the Court below consists in failing to recognize that here, as in *Cuba Railroad*, the receipt of benefits from operation of the facility is completely without significance in testing whether the funds are gain or capital.

2. For the reasons stated herein and in the petition for writ of certiorari, the decision of the

Court below is in conflict, inter alia, with *Edwards* v. *Cuba Railroad Co.*, 268 U.S. 628 (1925), and with the interpretation of that case in *Texas & Pacific Ry. Co.* v. *United States*, 286 U.S. 285, 289-290 (1932), and other cases cited (Pet. 8). The statement of this Court in *Cuba Railroad*, "The subsidy payments taxed were not made for services rendered or to be rendered," 268 U.S. at 633, was in the nature of an ultimate finding based upon facts in that case which in all *essential* particulars—the reimbursement of a corporation for capital expenditures, by a donor which anticipated receiving direct benefits from the operation of the facility—are on all fours with the instant case.

In stating (Res. Br. 9) that the decision below is not in discord with *Bonnet* v. *Helvering*, 137 F. 2d 537 (2d Cir., 1943), respondent apparently disavows the concurring opinion in his favor in the Tax Court below by Judge Opper, who expressly stated, "In other words, if the *Bonnet* result is right, the present conclusion must be wrong." (R. 33). Judge Opper was, however, correct in recognizing a conflict in the underlying basis for the results of the *Bonnet* decision and the opinion of the Tax Court below—under the reasoning of the *Bonnet* case, the holding in *Detroit Edison Co. v. Commissioner*, 319 U.S. 98 (1943), that the contributions were not deductible as basis for depreciation required that they also be held not properly reportable as income.

The Tax Court decisions cited by petitioner as following the *Cuba Railroad* doctrine (Pet. 15a) do not merely "appear inconsistent" (Res. Br. 9) with the decisions of the Courts below, they are in direct conflict with those cases, as both Courts below acknowledged (Pet. 15a). Whether or not the Tax Court is

at liberty to reconsider its previous position, after thirty years of judicial, legislative, and administrative acquiescence, it should not be permitted to do so, in the absence of a direct compelling mandate from a higher authority, without full judicial review of the basis for its reversal of precedent. Further judicial review by this Court would appear to be particularly appropriate in this case, where the ratio decidendi is an opinion of this Court (*Detroit Edison Co.* v. *Commissioner*, 319 U.S. 98 (1943), which is admittedly no direct precedent but only "an illuminating guide" (Pet. 12a).

Respondent's brief states, "The decision of the Court of Claims (*Texas & P. Ry. Co.* v. *United States*, 52 F. 2d 1040 [(Ct. Cl., 1931), aff'd without discussion of this point, 286 U.S. 285 (1932)]) upon which taxpayer also relies, follows the early Tax Court decisions which have since been rejected." (Res. Br. 10). They have been rejected, however, only by the Tax Court in this case; they have never been rejected by the Court of Claims. The decision of the Court below, therefore, continues to be in direct conflict with the decision of the Court of Claims.

The "Commissioner's acquiescence in these early Tax Court decisions which both the Tax Court and the court below have now repudiated as unsound in the light of intervening decisions of this Court," (Res. Br. 10), it may be observed, was a uniform acquiescence of thirty years, continuing until the instant case, although the bases for its present repudiation is one case decided back in 1943, *Detroit Edison Co.* v. *Commissioner*, 319 U.S. 98 (1943), and another decided in 1950, *Brown Shoe Co.* v. *Commissioner*, 339 U.S. 583 (1950).

3. Petitioner relies upon Section 118(a) of the Internal Revenue Code of 1954 as a restatement of existing law affirming the non-inclusion of contributions to the capital of a corporation in income taxation. The law existing in 1954 which defined what constitutes contributions to capital was thirty years of decided cases, which concededly "cannot be distinguished factually" (Pet. 15a) from the instant case and which have now been overruled.

4. Petitioner asserts not only that this case presents an important problem because of accounting requirements for regulated utilities (cf. Res. Br. 10-11 with Pet. 15-16), but also that this case will directly affect the various companies enumerated in the petition in a number of other ways, as set forth in the petition:

(1) Since preceding cases "cannot be distinguished factually" (Pet 15a), the companies enumerated as well as petitioner will be required to pay income taxes upon contributions heretofore considered not includable in gross income, presumably with retroactive effect.

(2) At the same time, the companies will not be permitted to include the sums received in their rate base for rate-making purposes under existing uniform systems of account.

(3) There is considerable question whether such contributions may be allowed as a basis for depreciation under the decision of this Court in the *Detroit Edison* case if, as stated (Pet. 12a), there are no substantial factual distinctions.

CONCLUSION

For the foregoing reasons, in addition to those heretofore urged in the petition for writ of certiorari herein, it is respectfully submitted that said petition for writ of certiorari should be granted.

Respectfully submitted,

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